

JAMAICA SOCIAL SAFETY NET REFORM PROGRAM (1355\OC-JA) LOAN INCREASE PROPOSAL

A. INTRODUCTION

- 1.1 The Government of Jamaica has requested an increase in the size of the Social Safety Net (SSN) Reform Loan (1355/OC-JA), which was approved by the Board on October 3, 2001, but has not yet been signed. The size of the loan is \$40 million and is scheduled to be disbursed in two equal tranches; the government has asked the Bank to increase the size of the loan to \$60 million, to be disbursed in two equal tranches of \$30 million each (see attached letter).
- 1.2 The original loan amount for the SSN Reform Program was agreed to with the authorities based on the growth, revenue, and spending projections contained in the Staff Monitored Program (SMP), which was worked out between the GOJ and the IMF. Given these projections and the amount of the operation, the Bank and the GOJ agreed to a significant real increase (15%) in the budget allocation to basic health, education, and poverty alleviation programs during the current fiscal year, amounting to approximately 8% of the non-debt non-salary budget. However, recent adverse events outside the government's control, particularly the impact of the September 11 terrorist attacks, coupled with an outbreak of social unrest in July and severe storm damage caused by Hurricane Michelle in November, have drastically altered the country's growth and fiscal prospects over the short to medium term. These events have prompted the GOJ to request special assistance from the IDB in order to minimize the social consequences of these events.

B. MACROECONOMIC PROGRAM PRIOR TO SEPTEMBER 11

- 1.3 Jamaica experienced low GDP growth in the early 1990s and four years of decline in real GDP in the late 1990s, resulting in an average annual erosion of *per capita* GDP of one percent over the course of the decade as a whole. Among factors obstructing growth were high domestic interest rates, which were linked to the deficits, and a spiral of domestic debt accumulation. Public debt now represents about 138 percent of GDP, while interest on the public sector debt is projected to absorb approximately 50 percent of total revenue plus grants in FY 2001/02.¹
- 1.4 To meet its interest service obligations the GOJ has generated a primary surplus of over 10 percent of GDP, which reflects the high fiscal sacrifice necessary to manage the debt, and represents a diversion of resources that could otherwise be applied to capital expenditure, poverty alleviation and social spending. Up to May 2001, the IMF reported that economic developments in Jamaica were proceeding in conformity with the SMP targets. Interest rates and the inflation rate continued to be on a declining trend. The real exchange rate maintained a

¹ The fiscal year in Jamaica runs from April 1 to March 31.

non-appreciating path and international reserves were rising. The central government fiscal deficit was reduced from an average of 7 percent of GDP in the late 1990s to 1 percent in 2000/01 while the fiscal deficit of the consolidated public sector was reduced from 11 percent of GDP in 1998/99 to 5 percent in 2000/01. Given the country's success in meeting the broad targets in the SMP, Standard & Poors upgraded Jamaica's long-term sovereign bond rating to B+ for foreign currency bonds in May 2001, and sovereign bond spreads declined by around 150 basis points.

C. IMPACT AND ASSESSMENT OF GAPS

- 1.5 The September 11 terrorist attack has had a profound impact on the tourist industry, which represents 50% of all foreign exchange earnings and approximately 20% of GDP. This shock occurred in the wake of an episode of social unrest in July, and was followed by severe flood damage caused by Hurricane Michelle in early November. The social unrest caused a substantial, unanticipated increase in Government expenditure for the security forces and additional tourism promotion to counteract the negative image abroad. The hurricane did considerable damage to roads, bridges and other important infrastructure, severely obstructing access to parts of the island. Consequently, following the improvement in growth in 2000 and a good start to 2001, these shocks have significantly set back the growth of the Jamaican economy and created significant resource gaps.

1. Tourism Impact

- 1.6 The September 11 events have impacted severely on the tourism industry of Jamaica. Total stopover visitor arrivals fell by 20 percent in September 2001, compared to September 2000. The September 2001 reduction followed declines of 5 and 4 percent in July and August, respectively, which were attributable to the community unrest which erupted in Kingston in early July. It is estimated that visitor arrivals will fall by 20-25 percent for the rest of 2001 and possibly for the remainder of FY 2001/02. Cruise arrivals declined by 14 and 24 percent in August and September 2001, respectively, and further decline is forecast for the rest of the year. The immediate impact of these reductions in tourist arrivals is projected to be a 9 percent reduction in visitor expenditure in the current fiscal year.

2. Output and Employment

- 1.7 The tourist shocks have contributed to reduced output and employment in the industry and in the country as a whole. Reduced tourism business is also causing reduced demand for agricultural products used in the industry and other services geared for tourists such as duty-free shopping, ground transportation, entertainment and restaurants. Export agriculture was directly affected in the immediate wake of the disaster, as perishable goods were lost due to shipping

delays. It has been estimated that the disruption in transportation immediately following the September 11 tragedy caused a loss of US\$400,000 in export revenue. Security measures will continue to put a drag on agriculture exports.

- 1.8 An attempt is now being made to measure the extent of these losses, taking into account the subsequent rounds of deterioration as the multiplier effects occur. Prior to September 11, the Jamaican economy was estimated to be on track for GDP growth of around 3 percent. This growth was supported by a good agriculture performance caused by improved weather conditions, a turnaround in manufacturing and the resumption of bauxite sales to Gramercy, following its closure for repairs. In the wake of the September 11 disaster, the GOJ Authorities are now projecting a GDP growth rate of around 1 percent.
- 1.9 The decline in output growth will inevitably cause a rise in unemployment because it affects industries such as tourism and agriculture, which are labor-intensive. Hotels have already been forced to lay off workers or reduce their employment in response to declining occupancy rates. Attempts are now being made to assess the impact with respect to unemployment.

3. Balance of Payments Impact

- 1.10 On the basis of these external movements, the current account deficit is forecast to grow by 57 percent in FY2001/02. The main contributor to this deterioration is the downturn in tourism receipts, while the movements with respect to merchandise trade are somewhat offsetting. The overall external impact is expected to be a reduction in net international reserves by US\$91 million (7 percent) to US\$1.2 billion representing 15 weeks of gross reserve coverage of goods and services imports.

4. Fiscal Impact

- 1.11 According to GOJ projections, the September 11 events are expected to cause a deterioration in the fiscal balance of US\$145 million, equal to 1.9 percent of GDP in FY01-02. Total revenue will decline by 1 percent of GDP while expenditure will increase by 0.9 percent of GDP. Consequently, the overall central government fiscal deficit is projected to rise to US\$420 million or 5 percent of GDP in FY01-02. This deficit is substantially higher than the existing SMP target and will have important repercussions with respect to the path of changes in public debt, interest rates, and ultimately, growth in the medium term.

D. BANK ACTION

- 1.12 The main challenge facing the GOJ during this period of distress is to maintain a sustainable macroeconomic program with minimal social repercussions. The IDB and other multilateral agencies can best support the efforts of the GOJ by providing assistance that will help them to maintain important social services and capital expenditures.

- 1.13 Increasing the SSN Reform Loan is the first in a set of complementary actions the Bank is undertaking as a timely response to the situation in Jamaica. These actions include a review of the present portfolio and pipeline to determine if there are ways of expediting disbursements. This would involve, for example, the possible re-programming of an unutilized loan balance in the amount of US\$8 million under the Health Sector Reform Project (1028/OC-JA). The Bank is also exploring the possibility of dividing the original second tranche of the Financial Sector Reform Loan (1268/OC-JA) into two separate tranches. Provided an agreement is reached on this restructuring and on the appropriate conditionality, a tranche disbursement could be available by January. The GOJ has requested that CEPAL conduct a rapid assessment of the economic impact of the damage caused by Hurricane Michelle and, based on this assessment, the Bank is prepared to examine how additional resources can be provided to Jamaica under the Emergency Reconstruction Facility. Finally, the Bank is working closely with Jamaica to obtain early access to the proposed new MIF line of activity to strengthen airport security.
- 1.14 The Bank is pursuing the actions mentioned above as part of a collaborative effort among the multilateral agencies to respond to the Jamaican crisis. The IMF is undertaking a mission to Jamaica from November 26 to December 1 to agree on revised targets under the SMP in light of recent developments. The World Bank undertook a mission to Jamaica during November 4-10 to prepare an economic rehabilitation loan (ERL) of \$75 million in response to the conditions affecting the country following the September 11 disaster, and taking into account the damage caused by Hurricane Michelle. The World Bank is aiming for a December date for its Board consideration of the ERL, and has also begun preparations for a loan to replenish the Jamaica Social Investment Fund. The results of the hurricane damage assessment could also provide the basis for further assistance to Jamaica from the Caribbean Development Bank.

E. RECOMMENDATION

- 1.15 In light of the unique and unprecedented events of September 11, and the impact of this shock on the tourism sector in Jamaica, Management recommends that the SSN Reform Loan be increased to \$60 million, to be disbursed in two equal tranches of US\$30 million each. This action would assist the GOJ in maintaining its macroeconomic program while minimizing the effect of the shock on poor and vulnerable groups in the country, thus helping to achieve compliance with the second tranche conditionalities.